IFRS

STAFF PAPER

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IFRS Interpretations Committee Meeting

Project	New items for initial consideration
Paper topic	IFRS 2 *Share-based Payment* —accounting for cash-settled share-based payment transactions that include a performance condition

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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

Introduction

1. In April 2013, the IFRS Interpretations Committee (the 'Interpretations Committee') received a request to clarify the accounting for cash-settled share-based payment transactions that include a performance condition. This is because the submitter thinks that IFRS 2 *Share-based Payment* does not specifically address the accounting for these transactions and this has led to diversity in practice.

2. We performed outreach with the International Forum of Accounting Standard-Setters (IFASS) and securities regulators on this topic in order to find out whether the issue raised by the submitter is widespread and whether significant diversity in practice exists. The results of this outreach are included as part of our analysis of this issue.

3. The submission is reproduced in full in **Appendix C** to this paper.

Purpose of the paper

4. The purpose of this paper is to:

(a) provide an analysis of the issue raised in the submission;

(b) provide a summary of the outreach results on the issue raised;

(c) present an assessment of the issue against the Interpretations Committee's agenda criteria;

(d) make a recommendation to amend IFRS 2 (we have set out the wording for the proposed amendment in **Appendix B** of this paper); and

(e) ask the Interpretations Committee whether it agrees with the staff recommendation.

Submission description

5. The submitter observes that paragraph 19 of IFRS 2 contains specific guidance for the measurement of equity-settled share-based payment transactions that include *vesting conditions*[1] other than market conditions (ie performance and service conditions; see paragraphs 19–21) and market and non-vesting conditions (see paragraph 21A).

6. However, IFRS 2 does not specifically address the impact of vesting conditions (including the effect of a performance condition) within the context of cash-settled share-based payment transactions.

7. The submitter further notes that, on the basis of paragraph 3A of IFRS 2, the fair value of equity-settled share-based payments is not based on the notion of 'fair value' as defined in IFRS 13 *Fair Value Measurement*, because the fair value measurement of equity-settled awards at grant date does not take into account the impact of vesting conditions other than market conditions.

8. However the submitter thinks that it is not clear in IFRS 2 whether the measurement at fair value of cash-settled share-based payments that include a performance condition should be based on the notion of 'fair value' as defined in IFRS 13 or as defined in IFRS 2.

[1] According to Appendix A of IFRS 2, vesting conditions are either service conditions, performance conditions or market conditions. Non-vesting conditions are not defined in IFRS 2.

9. With regard to the accounting for cash-settled awards that include a performance condition, the submitter observes that:

   (a) some think that the implementation guidance in Example 12 of IFRS 2 (which shows an illustration of the accounting for the effect of a service condition in the measurement of a cash-settled award) might suggest that the accounting for a cash-settled award that includes a performance condition should be consistent with the measurement of equity-settled awards that include a performance condition in paragraph 19 of IFRS 2; whereas

   (b) others think that the measurement of cash-settled awards should reflect the impact of all conditions and all possible outcomes on a weighted-average basis consistent with IFRS 13.

10. The submitter supports the view that the measurement of cash-settled share-based payments should take into account all terms and conditions of the award and proposes that an example should be included in the implementation guidance in IFRS 2, that would illustrate this view for cash-settled awards that include a performance condition.

11. The submitter asks the Interpretations Committee to clarify the accounting for cash-settled awards that include a performance condition, because the guidance in IFRS 2 is leading to divergent interpretations.

Summary of outreach activities

12. We asked securities regulators and national standard-setters to provide us with information on whether the issues raised in the submission:

   (a) are widespread and have practical relevance; and

   (b) indicate that there are significant divergent interpretations (either emerging or existing in practice).

13. We asked the following questions:

(a) **Question 1** (Q1): are cash-settled share-based payment transactions that include a performance condition common or relevant in your jurisdiction?

(b) **Question 2** (Q2): if yes to Q1, what is the prevalent approach in your jurisdiction to account for these transactions? If you see diversity in practice in that accounting, please explain how.

Responses from national standard-setters and regulators

14. We received responses from IOSCO and fourteen national standard-setters.

15. We summarise the results of the outreach in the following paragraphs. The views expressed below are informal opinions from IOSCO and the national standard-setters. They do not reflect the formal views of those organisations.

Responses received from regulators

16. In response to Q1, a majority of those who responded think that cash-settled share-based payment transactions that include a performance condition are not very common or widespread. However, two IOSCO members indicated that cash-settled share-based payment transactions that include a performance condition are common and relevant.

17. In response to Q2, a majority of those who responded think that the prevalent approach is to account these transactions in a similar way as for equity-settled share-based payment transactions under IFRS 2. Only one member noted that that there are different views on this issue.

Responses received from national standard-setters

18. The geographical breakdown for the responses received from national standard-setters is as follows:

Geographical region	Number of respondents
Asia	5
Europe	4
Americas	3
Oceania	1
Africa	1
Total respondents	**14**

19. With respect to whether cash-settled share-based payment transactions that include a performance condition are common or relevant (Q1):

    (a) six respondents think that these transactions are common;

    (b) six respondents believe that, despite the fact that these transactions are not common in their jurisdiction, they are relevant; and

    (c) two respondents observe that these transactions are uncommon in their jurisdiction and did not provide any further comments.

20. With respect to whether there is a prevalent approach to account for cash-settled share-based payment transactions that include a performance condition (Q2):

    (a) eight respondents observe that there is diversity in practice in the accounting for such transactions. Some would include the effect of a performance condition in the measurement of a cash-settled liability whereas others would apply the same approach as for equity-settled awards.

    (b) four respondents note that such transactions should be accounted for consistently with the guidance for equity-settled share-based payment transactions.

    (c) two respondents did not indicate whether there should be a prevalent approach to account for these transactions.

Staff analysis

21. The guidance in IFRS 2 for measuring equity-settled share-based payment transactions and for measuring cash-settled share-based payment transactions is included in **Appendix A** of this paper.

Approaches identified

22. We have identified the following approaches to account for the effect of cash-settled share-based payment transactions that include a non-market performance condition:

    (a) **Approach A**—follow an equity–settled measurement model.

    (b) **Approach B**— follow a cash–settled measurement model.

Approach A—follow an equity–settled measurement model

23. Proponents of Approach A observe that the guidance in paragraphs 19–21 of IFRS 2 (included in **Appendix A** of this paper) for measuring the effect of vesting conditions (including a non-market performance condition) on equity-settled share-based payment transactions could be applied by analogy when measuring a cash-settled share-based payment transaction that includes a performance condition. This is because they observe that:

    (a) as noted explicitly in paragraph 6A of IFRS 2, the notion of 'fair value' in IFRS 2 should not be consistent with the notion of 'fair value' as defined in IFRS 13 *Fair Value Measurement*; and

    (b) the guidance in Example 12 of the Implementation Guidance in IFRS 2, which refers to the measurement of a cash-settled share-based payment transaction that includes a service condition, might suggest that the accounting for a cash-settled award that includes a performance condition should be consistent with the accounting for the effect of a vesting condition (other than a market condition) in an equity-settled award.

The notion of 'fair value' in IFRS 2 is not consistent with IFRS 13

24. Paragraph 6A in IFRS 2 states that:

> This IFRS uses the term 'fair value' in a way that differs in some respects from the definition of fair value in IFRS 13 *Fair Value Measurement*. **Therefore, when applying IFRS 2 an entity measures fair value in accordance with this IFRS, not IFRS 13.**

25. Proponents of Approach A observe that paragraphs 19–21 in IFRS 2 draw a distinction between vesting and non-vesting conditions and according to this guidance each condition affects the measurement of the equity-settled award in a different way; for instance:

    (a) non-vesting conditions and market conditions affect the measurement of the fair value at grant date; whereas

    (b) vesting conditions (other than market conditions) do not affect the fair value at grant date; however they are taken into account in the measurement of the equity instrument by adjusting the number of equity instruments that will eventually vest.

26. Because paragraph 6A is clear that an entity should follow the notion of 'fair value' in IFRS 2 and the guidance for equity-settled awards is specific about the impact of vesting and non-vesting conditions on the measurement of fair value, proponents of Approach A think that the guidance for equity-settled awards should be applied by analogy to measure the fair value of a liability arising from a cash-settled award.

Implementation Guidance for cash-settled awards

27. Example 12 of the Implementation Guidance of IFRS 2 shows an illustration of how to account for the effect of a service condition in the measurement of a cash-settled award. This example illustrates the case of a cash-settled award by which an entity grants share appreciation rights to its employees. The share appreciation rights (SARs) will not vest until the employees have completed a specified period of service.

28. This example is reproduced below.

IG Example 12

Background

An entity grants 100 cash share appreciation rights (SARs) to each of its 500 employees, on condition that the employees remain in its employ for the next three years.

During year 1, 35 employees leave. The entity estimates that a further 60 will leave during years 2 and 3. During year 2, 40 employees leave and the entity estimates that a further 25 will leave during year 3. During year 3, 22 employees leave. At the end of year 3, 150 employees exercise their SARs, another 140 employees exercise their SARs at the end of year 4 and the remaining 113 employees exercise their SARs at the end of year 5.

The entity estimates the fair value of the SARs at the end of each year in which a liability exists as shown below. At the end of year 3, all SARs held by the remaining employees vest. The intrinsic values of the SARs at the date of exercise (which equal the cash paid out) at the end of years 3, 4 and 5 are also shown below.

Year	Fair value	Intrinsic value
1	CU14.40	
2	CU15.50	
3	CU18.20	CU15.00
4	CU21.40	CU20.00
5		CU25.00

Application of requirements

Year	Calculation		Expense	Liability
			CU	CU
1	(500 – 95) employees × 100 SARs × CU14.40 × $^1/_3$		194,400	194,400
2	(500 – 100) employees × 100 SARs × CU15.50 × $^2/_3$ – CU194,400		218,933	413,333
3	(500 – 97 – 150) employees × 100 SARs × CU18.20 – CU413,333	47,127		460,460
	+ 150 employees × 100 SARs × CU15.00	225,000		
	Total		272,127	
4	(253 – 140) employees × 100 SARs × CU21.40 – CU460,460	(218,640)		241,820
	+ 140 employees × 100 SARs × CU20.00	280,000		
	Total		61,360	
5	CU0 – CU241,820	(241,820)		0
	+ 113 employees × 100 SARs × CU25.00	282,500		
	Total		40,680	
	Total		787,500	

29. Proponents of Approach A think that in Example 12 the accounting for the effect of the service condition is consistent with the accounting for the effect of a vesting condition (other than a market condition) in an equity-settled share-based payment in paragraphs 19–21 of IFRS 2. This is because they observe that during the vesting period, the fair value of the liability recognised at each reporting date is adjusted by considering the expected number of employees that will complete the specified service (ie the number of SARs expected to vest is calculated by multiplying the SARs granted by the expected number of employees that will complete the specified service). They believe that this methodology is similar to the methodology followed in paragraph 19 of IFRS 2 for considering vesting conditions (other than market conditions) in equity-settled awards.

30. Proponents of Approach A think that the guidance in Example 12 could be applied by analogy to account for the effect of a performance condition in a cash-settled award, because both a service condition and a performance condition are vesting conditions in accordance with IFRS 2.

31. Consequently, they think that the measurement of a cash-settled share-based payment transaction that includes a performance condition should be consistent with the accounting for the effect of vesting conditions (other than market conditions) in an equity-settled award.

32. Proponents of Approach A think that the accounting for a cash-settled share-based payment transaction that includes a performance condition would be as follows:

    (a) the initial measurement of the fair value of the liability would exclude the effect of both a service and a non-market performance condition;

    (b) service and non-market performance conditions would affect the measurement of the liability by adjusting (ie 'truing-up') the number of awards to receive cash, based on the best estimate of the service and non-market performance conditions that are expected to be satisfied.

33. Proponents of this approach think that no expense would be recognised if the achievement of a service or non-market performance condition is not probable.

Approach B—follow a cash-settlement model

34. Proponents of this approach think that the measurement of the fair value of the liability should include the impact of all conditions (including service and non-market performance conditions). This is because they observe that the guidance in paragraph 33 in IFRS 2 requires an entity to (emphasis added):

> [measure the fair value of the liability] initially and at the end of each reporting period until settled, **at the fair value of the share appreciation rights** by applying an **option pricing model**, **taking into account the effect of all terms and conditions** on which the share appreciation rights were granted and the extent to which the employees have rendered service to date.

35. Paragraphs B11–B15 in Appendix B of IFRS 2 include application guidance for using an option pricing model. Proponents of Approach B observe that, according to this application guidance, an entity would need to consider the expectations about the award and reflect those expectations in the measurement of the award. For example, paragraph B11 of IFRS 2 states that (emphasis added):

> **B11 In estimating the expected volatility of and dividends on the underlying shares, the objective is to approximate the expectations that would be reflected in a current market or negotiated exchange price for the option.** Similarly, when estimating the effects of early exercise of employee share options, **the objective is to approximate the expectations that an outside party with access to detailed information about employees' exercise behaviour** would develop based on information available at the grant date.

36. Consequently, proponents of this approach think that in measuring cash-settled awards under an option pricing model, the effect of service and performance conditions granted for the award should be considered when evaluating the expectations about the award.

37. On the basis of the guidance in paragraphs 30 and 33 in IFRS 2, proponents of Approach B think that the fair value of the liability should reflect the probability of all vesting and non-vesting conditions being met, as follows:

    (a) the fair value of the liability would be determined, initially and at each reporting date until settled, using an option pricing model (based on the guidance in paragraphs B11–B41 of IFRS 2) by taking into account all terms and conditions on which the cash-settled transaction was granted and the extent to which employees have rendered service; and

    (b) any change in the fair value of the recognised liability at the end of each reporting period and until the liability is settled would be considered a remeasurement (including any adjustment to the fair value of the liability due to revisions in the estimate of the outcome of vesting and non-vesting conditions).

Our view

38. We support **Approach B**. We think that this approach is consistent with the measurement of the liability that arises from a cash-settled award at fair value in accordance with paragraph 30 of IFRS 2, given that the underlying principle in a fair value valuation is to include the effects of all significant conditions that may affect its value.

The guidance for cash-settled awards should be followed

39. We observe that paragraph 33 of IFRS 2 requires that the liability arising from a cash-settled share-based payment transaction should be measured by taking into account all the terms and conditions on which the cash-settled awards are granted. In this respect we disagree with those who think that, because share based-payments within the scope of IFRS 2 (see paragraph 6A of IFRS 2) are excluded from the scope of IFRS 13, it is not necessary to reflect the impact of all conditions and all possible outcomes in the measurement of a liability that arises from a cash-settled award.

40. We think that the inclusion of a scope exclusion in paragraph 6A of IFRS 2 (ie stating that the notion of fair value is not the same as the notion of fair value in IFRS 13) does not override the existing guidance for measuring cash-settled awards at fair value in paragraph 33.

41. We think that the guidance in paragraph 33 could be reinforced by additional guidance that would indicate that, for cash-settled share-based payment transactions, an entity should take into the account the effect of vesting and non-vesting conditions when initially measuring the fair value of the liability and at the end of each reporting period until settled.

Rationale for the scope exclusion in paragraph 6A

42. We observe that paragraph 6A was included because some of the measurements in IFRS 2 were not consistent with the fair value measurement objective in IFRS 13.

43. The rationale for including the scope exclusion in paragraph 6A of IFRS 2 is explained in paragraph BC21 of IFRS 13 (emphasis added):

> BC21 The exposure draft proposed introducing a new measurement basis for IFRS 2, a market-based value. The definition of market-based value would have been similar to the exit price definition of fair value except that it would specify that the measurement does not take into account market participant assumptions for vesting conditions and reload features. Respondents pointed out that some items measured at fair value in IFRS 2 were consistent with the proposed definition of fair value, not with the proposed definition of market-based value, and were concerned that there could be unintended consequences of moving forward with a market-based value measurement basis in IFRS 2. **The IASB agreed with those comments and concluded that amending IFRS 2 to distinguish between measures that are fair value and those based on fair value would require new measurement guidance for measures based on fair value. The IASB concluded that such guidance might result in**

> **unintended changes in practice with regard to measuring share-based payment transactions and decided to exclude IFRS 2 from the scope of IFRS 13**.

44. We observe that in IFRS 2, the measurement guidance for equity instruments in IFRS 2 is not consistent with the notion of "the exit price" in IFRS 13. This is because the effect of service and performance conditions are not taken into account when estimating the fair value of the equity instruments granted, and, consequently, the measurement guidance results in a measurement that is based on fair value but is not in itself a fair value measurement. If this measurement had been consistent with the notion of fair value in IFRS 13, all vesting conditions would have been taken into account in the measurement

45. Paragraph 24 of IFRS 13 refers to the notion of 'exit price' as follows (emphasis added): [2]

> **Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (ie an exit price)** regardless of whether that price is directly observable or estimated using another valuation technique

46. In the case of cash-settled share-based payment transactions, the settlement of cash-settled SARs involves an outflow of cash (rather than the issue of equity instruments). Consequently, an entity determines the fair value of the liability (and not the fair value of the equity instruments granted) in accordance with the usual accounting for similar liabilities.

47. The outflow of cash in the settlement of SARs would imply the use of an 'exit price' measurement, which would be consistent with IFRS 13. However, the measurement of the liability takes into account both the intrinsic value of the SARs (the increase in the share price to date) and the time value of the SARs. The

[2] This is, when the fair value of the equity instruments is used as a surrogate to measure the value of goods or services received (refer to paragraph 10 in IFRS 2).

latter would suggest that, similar to equity-settled awards, the measurement of a liability arising from a cash-settled award results is based on fair value but is not in itself a fair value measurement. We observe that these aspects are discussed in paragraphs BC246 –BC249 of IFRS 2, as reproduced below (emphasis added):

> **How should the liability be measured?**
>
> BC246 A simple approach would be to base the accrual on the entity's share price at the end of each reporting period. If the entity's share price increased over the vesting period, expenses would be larger in later reporting periods compared with earlier reporting periods. This is because each reporting period will include the effects of (a) an increase in the liability in respect of the employee services received during that reporting period and (b) an increase in the liability attributable to the increase in the entity's share price during the reporting period, which increases the amount payable in respect of past employee services received.
>
> BC247 **This approach is consistent with SFAS 123** (paragraph 25) and FASB Interpretation No. 28 Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans.
>
> BC 248 However, **this is not a fair value approach**. Like share options, **the fair value of SARs includes both their intrinsic value (the increase in the share price to date) and their time value (the value of the right to participate in future increases in the share price**, if any, that may occur between the valuation date and the settlement date). An option pricing model can be used to estimate the fair value of SARs.
>
> BC249 Ultimately, **however, no matter how the liability is measured during the vesting period, the liability—and therefore the expense—will be remeasured, when the SARs are settled, to equal the amount of the cash**

> **paid out. The amount of cash paid will be based on the SARs' intrinsic value at the settlement date**. Some support measuring the SAR liability at intrinsic value for this reason, and because intrinsic value is easier to measure.

The guidance in Example 12

48. We disagree with the view that the guidance in Example 12 suggests that the measurement of a cash-settled share-based payment transaction that includes a service condition appears to be consistent with the accounting for the effect of vesting conditions (other than market conditions) in an equity-settled award.

49. In our view the guidance in Example 12 appears to be consistent with the measurement of cash-settled awards as it considers the conditions on which SARs were granted.

50. We think that the guidance in Example 12 is consistent with the measurement of a cash-settled award, because it takes into consideration the possibility that nothing will be paid to some employees (because some of them will leave) and it includes the recognition of the expense for only a portion of the award for those employees that will satisfy the service condition. In addition, it fulfils the objective of:
    (a) measuring the liability at fair value (paragraph 30);
    (b) adjusting the liability by revisions to the estimate of the outcome of the service condition (paragraphs 30 and 33); and
    (c) recognising the services received and the liability to pay for those services as the employees render service (paragraph 32).

51. Furthermore, we observe that paragraph IG19, which introduces Example 12, is consistent, at least in principle, with the guidance in paragraph 33 of IFRS 2 for cash-settled share-based payments, because it states that the liability should be measured initially and at the end of each reporting period until settled at the fair value of the share appreciation rights by applying an option pricing model. However, contrary to paragraph 33, it does not mention that an entity should consider, in the valuation of a cash-settled award, all the terms and conditions on

which such share appreciation rights were granted. We think that the wording in paragraph IG19 could be slightly modified to reinforce the guidance in paragraph 33 that all the terms and conditions on which such share appreciation rights were granted are considered in the measurement of the fair value of the award.

52. We do, however, think that Example 12 fails to give conclusive results on the methodology that should be followed when measuring a cash-settled award that includes a service condition.

53. In Example 12 the calculation of the liability is adjusted by revisions to the estimate of the outcome of the service condition. In the calculation of this adjustment the service condition is taken into account by adjusting the number of SARs that would eventually vest in a similar manner to how a service condition is recognised for an equity-settled award, in accordance with paragraph 19 of IFRS 2.

54. Some, however, would apply this methodology in a different way and think that the revisions to the estimate of the outcome of the service condition would be taken into account in the fair value of the SARs and not in the number of SARs for which the condition would be satisfied.

55. We illustrate these two views using the data for Year 1 in Example 12:

> An entity grants 100 SARs to each of its 500 employees on condition that they remain in service for 3 years.
>
> In Year 1, 35 employees leave and the entity estimates that a further 60 employees will leave during Years 2 and 3.
>
> Consequently, in Year 1 there is an 81 per cent chance that employees will satisfy the service condition. The fair value of the SAR for Year 1 is CU14.40.[3]
>
> <u>Calculation of the corresponding liability for Year 1:</u>

[3] This was calculated as 1- (95/500), which reflects the possibility that only 81% of the employees will satisfy the service condition.

(a) **Option 1:** the cost of the liability would be adjusted (ie 'trued-up') by the number of SARs that will ultimately vest, as follows:

(500-95) employees x 100 SARs x CU 14.40 x 1/3 = 194,400.

(b) **Option 2:** the service condition would impact the estimation of the fair value of the SAR:

500 employees x 100 SARs x 81% x CU 14.40 x 1/3 = 194,400.

56. Nevertheless, as we have mentioned before, we think that the methodology used in Example 12 for calculating the fair value of the liability does not contradict the guidance for measuring cash-settled awards in paragraphs 30–33 and for this reason we do not think it should be amended further.

57. We agree, however, with the submitter that clarity could be provided if another example is included in the Implementation Guidance of IFRS 2 to address the impact of a performance condition in the measurement of a cash-settled share-based payment transaction. We have analysed the example proposed by the submitter and we think that this example could be part of the additional guidance after a few edits (we have included this example in **Appendix B** of this agenda paper).

Understanding the effects of applying each approach

58. We observe that in examples with a large population of employees (as it is the case in Example 12) it would be difficult to identify the main differences between the application of an equity-settled measurement model (applied by analogy based on the guidance in paragraph 19 of IFRS 2) and the application of a fair value approach (based on the guidance in paragraph 33 of IFRS 2) to recognise the effect of a service condition on a cash-settled award.

59. To understand the effects of the approaches described in this paper (ie Approach A and Approach B), we could refer to Example 12 but assume instead that the entity has only one employee (instead of 500).

60. Consequently, if we assume that an entity grants 100 SARs to one single employee and that there is a 20 per cent chance that the employee will leave, we will obtain the following results using the two approaches:

> Using **Approach A** (analogy to equity-settled measurement model) an entity will consider that because the probability is 80% that the employee will meet the service condition, this means that it is probable (more likely than not) that the awards will vest and so all awards are included in the calculation. Consequently, it will recognise:
>
> 100 x 100% CU 14.4 x 1/3 = CU 480
>
> Using **Approach B** (cash-settled measurement model) an entity will consider a 20 per cent possibility that nothing will be paid to the employee and will recognise the expense only for an 80 per cent of the award. Consequently, it will recognise:
>
> 100 x 80% CU 14.4 x 1/3 = CU 384

61. We can also see a distinction in the application of the two approaches presented in this paper if we take the example proposed by the submitter for Year 1 (we have included this example in **Appendix B** of this Agenda Paper).

> In year 1 proposed Example 12A assumes that there is a 40 per cent probability that the revenue target will be attained at the end of Year 3. In Year 2, the entity estimates that there is a 70 per cent probability that the revenue target will be attained at the end of Year 3.
>
> Using **Approach A** (analogy to equity-settled measurement model). Consequently:
>
> - in Year 1 an entity will consider that the award is not probable of vesting because there is only a 40 per cent chance that the revenue target will be met and consequently the expense would be zero; and

- in Year 2 the probability of meeting the revenue target increases to 70 per cent so this means that it is probable (more likely than not) that the awards will vest and the entity will record a cumulative expense of CU516,667 (500 x 100 x CU 15.50 x 2/3).

Using **Approach B** (cash-settled measurement model) an entity will consider each year the possibility that the award has of vesting:

- in Year 1 the expense would be CU 96,000 (considering a 40 per cent probability); and
- in Year 2, the cumulative expense would be CU361,667 (considering a 70 per cent probability of meeting the revenue target in the second year)

62. Consequently, under Approach A the cumulative expense would be higher than in Approach B as the entity would recognise an expense for the full award in the second year.

Agenda criteria assessment

63. The staff's assessment of the agenda criteria[4] is as follows:

Agenda criteria

We should address issues (5.16):	
that have widespread effect and have, or are expected to have, a material effect on those affected.	**Yes** On the basis of our analysis of the outreach results received from standard-setters and regulators (refer to paragraphs 12 –20), we can indicate that this issue is considered to be widespread and diversity in practice exists.
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods.	**Yes.** We think that clarifying the guidance for measuring the effect of a performance condition in cash-settled share-based payment transactions and the Implementation Guidance in IFRS 2 would improve financial reporting.
that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial Reporting*.	**Yes.** We think that further guidance is needed to clarify that the measurement of the fair value of the liability shall take into the account the effect of service and performance conditions, when initially measuring the fair value of the liability and at the end of each reporting period until the liability is settled. This why we suggest adding paragraph 33A to IFRS 2. We also think that that clarity could be provided if another example is included in the Implementation Guidance in IFRS 2 to address the impact of a performance condition in the measurement of a cash-settled share-based payment transaction. This why we suggest adding IG Example 12A.
In addition:	
Is the issue sufficiently narrow in scope that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process that would be required when making changes to IFRSs (5.17)?	**Yes.** We think that the proposed amendment should be included as part of the Annual Improvements process.
Will the solution developed by the Interpretations Committee be effective for a reasonable time period (5.21)? (The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified)...	**Yes.** The proposed amendment will be effective for a reasonable time period. As explained above, the proposed improvement is justified.

[4] These criteria can be found in the *IFRS Foundation Due Process Handbook* as indicated in the paragraphs below.

Additional criteria for annual improvements

In addition to the implementation and maintenance criteria, an annual improvement should (6.11, 6.12):	
• Replace unclear wording; • Provide missing guidance; or • Correct minor unintended consequences, oversights or conflict.	**Yes.** We have observed that there is diversity in practice in the accounting for cash-settled share-based payment transactions that include a performance condition. This is because the submitter thinks that IFRS 2 does not specifically address the accounting for these transactions and this has led to diversity in practice. We think that our proposal to add paragraph 33A and add Example 12A to IFRS 2 will clarify the accounting of cash-settled share-based payment transactions that include vesting conditions (including a performance condition) and non-vesting conditions.
Not change an existing principle or propose a new principle	**Yes.** We think that the proposed amendment is not changing an existing principle or proposing a new principle.
Not be so fundamental that the IASB will have to meet several times to conclude (6.14)	**Yes.** We think that the proposed amendment is not so fundamental that the IASB will have to meet several times to conclude.

Staff recommendation

64. We propose adding paragraph 33A to IFRS 2 to clarify that the measurement of the fair value of the liability shall take into account the effect of vesting conditions and non-vesting conditions when initially measuring the fair value of the liability and at the end of each reporting period until the liability is settled.

65. We also propose amending paragraph IG 19 of IFRS 2 to clarify that the initial measurement of the fair value of the liability and the measurement of the liability at the end of each reporting period until settled shall consider the effect of all the terms and conditions on which the share appreciation rights were granted.

66. We also propose adding Example 12A to the Implementation Guidance in IFRS 2 to address the impact of a performance condition in the measurement of a cash-settled share-based payment transaction.

67. On the basis of both our assessment of the Interpretations Committee's agenda criteria and our analysis in this paper, we think that our proposed amendments to

IFRS 2 meet the criteria for inclusion in the **Annual Improvements cycle for 2012–2014**.

Proposed amendment

68. Our proposals for amendment are shown in **Appendix B** of this paper.

Transition provisions and effective date

69. We propose that the amendment to IFRS 2 should be applied on a prospective basis rather than retrospectively because the proposed clarifications to the accounting for the effect of vesting and non-vesting conditions may result in changes to the timing and amount of the liability recognised at each reporting date.

70. We propose that an entity should apply the amendment prospectively for annual periods beginning on or after 1 January 2016. Earlier application should be permitted.

First-time adopters

71. We do not propose specific guidance for first-time adopters in the application of the proposed amendments because appropriate relief is already given through the exemptions for share-based payment transactions in Appendix D of IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

Consequential amendments

72. We have reviewed other IFRSs for potential consequential amendments triggered by this proposed amendment. As a result of this review, we do not propose any consequential amendments.

Question for the Interpretations Committee

Question for the Interpretations Committee
1. Does the Interpretations Committee agree with our conclusions in this paper? 2. Does the Interpretations Committee agree with our proposed amendments to: (a) add paragraph 33A to IFRS 2 to clarify that the measurement of the fair value of the liability shall take into account the effect of all conditions and that on a cumulative basis the total expense recognised will be the total amount of cash paid, as shown in **Appendix B**? (b) amend paragraph IG 19 of IFRS 2 to clarify that the initial measurement of the fair value of the liability and the measurement of the liability at the end of each reporting period until settled shall consider the effect of all the terms and conditions on which the share appreciation rights were granted, as shown in **Appendix B**? (c) add Example 12A to the Implementation Guidance in IFRS 2 to address the impact of a performance condition in the measurement of a cash-settled share-based payment transaction, as shown in **Appendix B**?

Appendix A
Guidance in IFRS 2 for measuring equity-settled and cash-settled share-based payment transactions

Guidance for equity-settled share-based payment transactions

A1. Paragraphs 19 –21A provide specific guidance on how to measure the effect of vesting and non-vesting conditions on equity-settled share-based payment transactions.

A2. According to the guidance in paragraphs 19 and 21 of IFRS 2:

(a) the fair value of the equity instruments at **grant date**:

(i) considers the effect of *market conditions* and non-vesting conditions; but

(ii) does not consider the effect of *vesting conditions* (other than market conditions).

(b) at each **subsequent reporting date until vesting**, the entity calculates its best estimate of the cumulative cost at that date, being the product of:

(i) the grant date fair value of the award;

(ii) the current best estimate of the number of awards that will be vested **considering the effect of *vesting conditions*** (other than market conditions); and

(iii) the expired portion of the vesting period.

A3. Paragraph 19 of IFRS 2 is reproduced below (emphasis added):

Treatment of vesting conditions

19 **A grant of equity instruments might be conditional upon satisfying specified vesting conditions.** For example, a grant of shares or share options to an employee is typically conditional on the employee remaining in the entity's employ for a specified period of time. There might be performance conditions that must be

> satisfied, such as the entity achieving a specified growth in profit or a specified increase in the entity's share price. **Vesting conditions, other than market conditions, shall not be taken into account when estimating the fair value of the shares or share options at the measurement date. Instead, vesting conditions shall be taken into account by adjusting the number of equity instruments included in the measurement of the transaction amount so that, ultimately, the amount recognised for goods or services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. Hence, on a cumulative basis, no amount is recognised for goods or services received if the equity instruments granted do not vest because of failure to satisfy a vesting condition, eg the counterparty fails to complete a specified service period, or a performance condition is not satisfied, subject to the requirements of paragraph 21.**

A4. Paragraph 20 is reproduced below (emphasis added):

> **To apply the requirements of paragraph 19, the entity shall recognise an amount for the goods or services received during the vesting period based on the best available estimate of the number of equity instruments expected to vest and shall revise that estimate**, if necessary, if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates. On vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested, subject to the requirements of paragraph 21.

A5. In accordance with paragraphs 19 and 21 of IFRS 2, the award is deemed to vest (and an expense is recognised):

(c) if the counterparty completes the specified service period or satisfies the performance condition; consequently, no expense is recognised for the failure to satisfy a service and/or a performance condition (see paragraph 19); and

(d) even if the non-vesting conditions and/or market conditions have not been satisfied (see paragraph 21).

A6. Paragraph 21 of IFRS 2 is reproduced below (emphasis added):

> 21 Market conditions, such as a target share price upon which vesting (or exercisability) is conditioned, shall be **taken into account when estimating the fair value of the equity instruments granted. Therefore, for grants of equity instruments with market conditions, the entity shall recognise the goods or services received from a counterparty who satisfies all other vesting conditions** (eg services received from an employee who remains in service for the specified period of service), **irrespective of whether that market condition is satisfied.**

A7. Paragraph BC184 of IFRS 2 explains why a distinction has been drawn in the accounting for different types of conditions affecting equity-settled awards. An extract of this paragraph is presented below (emphasis added):

> BC184…. Furthermore, **the practical difficulties that led the Board to conclude that non-market performance conditions should be dealt with via the modified grant date method rather than being included in the grant date valuation do not apply to market conditions, because market conditions can be incorporated into option pricing models. Moreover, it is difficult to distinguish between market conditions, such as a target share price, and the market condition that is inherent in the option itself**, ie that the option will be exercised only if the share price on the date of exercise

exceeds the exercise price. For these reasons, the Board concluded that the IFRS should apply the same approach as is applied in SFAS 123.

Guidance for cash-settled share-based payments

A8. Paragraphs 30 and 33 in IFRS 2 provide guidance on how to measure a cash-settled share-based payment transaction.

A9. Paragraph 30 of IFRS 2 requires an entity to:

(e) measure the goods or services acquired and the liability incurred at the fair value of the liability; and

(f) remeasure the fair value of the liability at the end of each reporting period and until the liability is settled, with any changes in fair value being recognised in profit or loss for the period.

A10. Paragraph 30 is reproduced below (emphasis added):

30 For **cash-settled share-based payment transactions, the entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability.** Until the liability is settled, the entity shall remeasure the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognised in profit or loss for the period.

A11. Paragraph 33 of IFRS 2 requires an entity to consider the effect of all the terms and conditions in accounting for the fair value of the cash-settled liability. Consequently, from the moment that a cash award is granted and until the liability is settled, the fair value of the liability has to be constantly remeasured to reflect any change in the circumstances in which the award was granted.

A12. Paragraph 33 is reproduced below (emphasis added):

33 **The liability shall be measured**, initially and at the end of each reporting period until settled, at the fair value of the

share appreciation rights, **by applying an option pricing model, taking into account the terms and conditions on which the share appreciation rights were granted, and the extent to which the employees have rendered service to date.**

Appendix B—Proposed amendments to IFRS 2

Proposed amendments to IFRS 2 *Share-based Payment*

Paragraphs 33A and 63B are added. Paragraph 33 is not proposed for amendment but is included here for ease of reference. New text is underlined.

Cash-settled share-based payment transactions

…

33 The liability shall be measured, initially and at the end of each reporting period until settled, at the fair value of the share appreciation rights, by applying an option pricing model, taking into account the terms and conditions on which the share appreciation rights were granted, and the extent to which the employees have rendered service to date.

33A The effect of vesting conditions and non-vesting conditions should be taken into account when estimating the fair value of the liability in accordance with paragraph 33.

Effective date

…

63B *Annual Improvements* [2012–2014] issued in [date] added paragraph 33A. It amended paragraph IG19 of the Implementation Guidance and added IG Example 12A. An entity shall apply those amendments prospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for annual periods beginning on or after 1 January 2016. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

Proposed amendments to the implementation guidance of IFRS 2 *Share-based Payment*

Paragraph IG19 2 is amended and IG Example 12A is added. New text is underlined.

Cash-settled share-based payment transactions

IG19 For example, an entity might grant share appreciation rights to employees as part of their remuneration package, whereby the employees will become entitled to a future cash payment (rather than an equity instrument), based on the increase in the entity's share price from a specified level over a specified period of time. If the share appreciation rights do not vest until the employees have completed a specified period of service, the entity recognises the services received, and a liability to pay for them, as the employees render service during that period. The liability is measured, initially and at the end of each reporting period until settled, at the fair value of the share appreciation rights, reflecting the terms and conditions on which the share appreciation rights were granted, by applying an option pricing model, and the extent to which the employees have rendered service to date. Changes in fair value are recognised in profit or loss. Therefore, if the amount recognised for the services received was included in the carrying amount of an asset recognised in the entity's statement of financial position (eg inventory), the carrying amount of that asset is not adjusted for the effects of the liability remeasurement. Example 12 illustrate~~s~~ the~~se~~ requirements~~.~~ in paragraph 33 of IFRS 2 when the cash award is subject to a service condition. Example 12A illustrates the requirements in paragraph 33 of IFRS 2 when the cash award is subject to a performance condition.

IG Example 12A

Background

An entity grants 100 cash-settled share appreciation rights (SARs) to each of its 500 employees on condition that the employees remain in its employment for the next three years and that the entity reaches a revenue target (CU18 in sales) at the end of Year 3. For simplicity, it is assumed that no employees are expected to leave and that none do leave.[5]

During Year 1, the entity estimates there is a 40 per cent probability that the revenue target will be attained at the end of Year 3. During Year 2, the entity estimates that there is a 70 per cent probability that the revenue target will be attained at the end of Year 3. At the end of Year 3, the revenue target was attained and 150 employees exercise their SARs. Another 150 employees exercise their SARs at the end of Year 4 and the remaining 200 employees exercise their SARs at the end of Year 5.

Using an option pricing model, the entity estimates the fair value of the SARs. The entity considers the impact of the revenue target performance condition in the calculation of the initial fair value of the liability and of the value of the liability at the end of each year, as shown below. At the end of Year 3, all SARs held by the remaining employees vest. The intrinsic values of the SARs at the date of exercise (which equal the cash paid out) at the end of Years 3, 4 and 5 are also shown below.

Year	Fair value of one SAR	Intrinsic value of one SAR
1	CU14.40	
2	CU15.50	
3	CU18.20	CU15.00
4	CU21.40	CU20.00
5		CU25.00

Application of requirement

Year	Calculation		Expense CU	Liability CU
1	500 employees × 100 SARs × 40% × CU14.40 × ⅓		96,000	96,000
2	500 employees × 100 SARs × 70% × CU15.50 × ⅔ – CU96,000		265,667	361,667
3	(500-150) employees × 100 SARs × CU18.20 – CU361,667	275,333		637,000
	+ 150 employees × 100 SARs × CU15.00	225,000		

[5] Currency amounts are denominated in 'currency units' (CU).

	Total		500,333	
4	(350 – 150) employees × 100 SARs × CU21.40 – CU637,000	(209,000)		428,000
	+ 150 employees × 100 SARs × CU20.00	300,000		
	Total		91,000	
5	CU0 – CU428,000	(428,000)		0
	+ 200 employees × 100 SARs × CU25.00	500,000		
	Total		72,000	
	Total		1.025,000	

Basis for Conclusions on the proposed amendments to IFRS 2 *Share-based Payments*

This Basis for Conclusions accompanies, but is not part of, the proposed amendments.

Cash-settled share-based payment transactions

BC1 The IASB received a request to clarify the accounting for cash-settled share-based payment transactions that include a performance condition. Paragraphs 19–20 of IFRS 2 contain specific guidance for the measurement of equity-settled share-based payment transactions that include vesting conditions other than market conditions (ie performance and service conditions). Paragraphs 21–21A contain specific guidance for the measurement of equity-settled share-based payment transactions that include market and non-vesting conditions. However, IFRS 2 does not specifically address the impact of vesting conditions (including the effect of a performance condition) within the context of cash-settled share-based payment transactions

BC2 The IASB observed that the Example 12 of the Implementation Guidance of IFRS 2 (which shows an illustration of the accounting for the effect of a service condition in the measurement of a cash-settled award) could be read as suggesting that the accounting for a cash-settled award that includes a service condition should be consistent with the measurement of equity-settled awards that include a performance condition as specified by paragraph 19 of IFRS 2. The IASB also observed that the guidance in paragraph 6A of IFRS 2, which requires an entity to follow the notion of 'fair value' in IFRS 2, could be read as requiring the same notion of fair value for cash-settled and equity-settled awards

BC3 The IASB observed that the Example 12 and paragraph 6A of IFRS 2 should not be interpreted as requiring the application by analogy of the guidance to account for the effect of vesting and non-vesting conditions as specified by paragraphs 19–21 of IFRS 2 for cash-settled awards.

BC4 The IASB noted that the guidance for measuring cash-settled awards requires an entity to measure the liability incurred for the goods or services received at fair value of the liability and to remeasure the fair value of such a liability at the end of each reporting period and at the date of settlement. Consequently, from the moment that a cash award is granted and until the liability is settled, the fair value of the liability must be constantly remeasured to reflect any change in the conditions or circumstances in which the cash award was granted. The IASB also noted that paragraph 33 of IFRS 2 requires an entity to consider the effect of all the terms and conditions (including service and non-market conditions) in accounting for the fair value of the cash-settled liability.

BC5 The IASB proposes to add paragraph 33A to clarify that the measurement of the fair value of the liability shall take into account the effect of all vesting conditions and non-vesting conditions, when initially measuring the fair value of the liability and at the end of each reporting period until the liability is settled.

BC6 The IASB also proposes to amend the implementation guidance in IFRS 2 by:

(a) amending paragraph IG 19 to clarify that the initial measurement of the fair value of the liability and the measurement of the liability at the end of each reporting period until settled shall consider the effect of all the terms and conditions on which the share appreciation rights were granted; and

(b) adding IG Example 12A to the Implementation Guidance of IFRS 2 to illustrate the impact of a performance condition in the measurement of a cash-settled share-based payment transaction.

Appendix C—Submission

B1 We received the following request. We have deleted details that would identify the submitter of this request.

IFRS 2 Share-based payment – Accounting for cash-settled share-based payment arrangements that include a performance condition

We suggest in this letter an issue that the IFRS Interpretation Committee might consider clarifying.

The issue

IFRS 2 does not specifically address the measurement of cash-settled share-based payment transactions that include a performance condition. Share-based payments in the scope of IFRS 2 are excluded from the scope of IFRS 13. The measurement of cash-settled share-based payments is being interpreted in different ways, leading to diversity in practice. This is illustrated by the extracts from published guidance attached as Appendix B.

IFRS 2 paragraph 30 states "For cash-settled share-based payment transactions, the entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability". IFRS 2 paragraph 33 explains that for a cash-settled share appreciation right “The liability shall be measured, initially and at the end of each reporting period until settled, at the fair value of the share appreciation rights, by applying an option pricing model, taking into account the terms and conditions on which the share appreciation rights were granted, and the extent to which the employees have rendered service to date”.

Equity-settled awards with a performance vesting condition are measured using the modified fair value approach described in IFRS 2 paragraph 19. This requires that a performance vesting condition is reflected in the number of awards expected to vest, not in the measurement of the fair value of the award. No expense is recognised for goods or services received where an award is not expected to vest because achievement of a performance condition is not probable.

IFRS 2 uses the term fair value but is excluded from the scope of the fair value guidance in IFRS 13. An equity-settled award is measured without taking account of factors, such as vesting conditions other than market performance conditions and reload features. This is clearly not fair value. It is less clear whether the measurement of a liability for a cash-settled share-based payment should be at fair value as defined in IFRS 13.

Some believe that the measurement of the fair value of the liability should reflect the weighted average impact of all conditions and all possible outcomes, consistent with IFRS 13. A liability based on fair value should be recognised for all cash-settled awards even where achievement of a performance or service condition is not probable. Fair value reflects the probability of meeting any vesting conditions. Supporters of this view believe that excluding IFRS 2 from the scope of IFRS 13 was simply a drafting expedient

and not an indication of a specific view regarding the measurement of cash-settled share-based payment liabilities. A modification to exclude from the scope of IFRS 13 equity-settled awards but include cash-settled awards would have been complicated.

Others consider that the guidance in IG Example 12 of IFRS 2 suggests that the fair value for each award should be measured and then the number of awards expected to vest should be estimated. This would be consistent with the treatment of an equity-settled award. Supporters of this view consider that the exclusion of IFRS 2 from the scope of IFRS 13 suggests that none of the references to fair value in IFRS 2 should be regarded as consistent with fair value as defined in IFRS 13.

We note that IG Example 12 includes a service condition that can be expressed in terms of the number of employees expected to complete the service condition and not a performance condition. The result of the two valuation approaches would be the same. This example therefore does not suggest that a liability should be recognised only for awards that are more likely than not to vest.

Example

An entity might grant share appreciation rights to employees under which the employees will become entitled to a cash payment (rather than an equity instrument) based on the increase in the entity's share price over a specified period. The employees will earn the award after providing three years of service if the entity also meets a revenue target at the end of year three.

Some argue that no expense should be recorded unless it is probable that the performance condition (the revenue target) will be met. They also believe that the measurement should follow the same approach as equity-settled awards, so if it is probable the performance condition will be met, an expense based on the total number of awards should be recognised.

Others believe that the impact of any conditions is a measurement issue and not a recognition issue. They argue that measurement should reflect the impact of all conditions and all possible outcomes on a weighted-average basis and compensation expense should be recorded for the cash-settled share-based payment, whether or not it is probable the performance condition will be met.

Current practice

We understand that current practice is mixed. Some entities measure cash-settled share-based payment transactions that include a performance condition in the same way as equity-settled share-based payment transactions and others measure the fair value of the instrument, taking into account the impact of all conditions and all possible outcomes on a weighted-average basis.

Question for the Committee

Should the liability for cash-settled share-based payments be measured at fair value or recognised only when it is probable that a performance condition will be met and the award will vest?

Reasons for the IFRIC to address the issue

Criteria	Assessment
Is the issue widespread and practical?	Awards with performance conditions are common. The accounting for cash-settled awards with a performance condition should be clear and not be subject to different interpretation.
Does the issue involve significantly divergent interpretations (either emerging or already existing in practice)?	Existing practice includes the divergent interpretations described above. The cumulative total expense will be the amount finally paid, but these interpretations can lead to significantly different timing for the recognition of that expense.
Would financial reporting be improved through elimination of the diversity?	The accounting for cash-settled awards with performance conditions should be consistent. Clarification would eliminate divergent application. The guidance currently has one example of a cash-settled award, which includes a service condition but it does not include a performance condition. IG Example 12 includes a forfeiture assumption, which would be incorporated into the accounting for an equity-settled and a cash-settled award in the same manner. Clarity would be provided if another example is included in the implementation guidance in IFRS 2 to address cash-settled awards with a performance condition. We set out in Appendix A suggested wording for an additional example, based on the assumption that the award is measured at fair value taking into account all terms and conditions.
Is the issue sufficiently narrow in scope to be capable of interpretation within the confines of IFRSs and the Framework for the Preparation and Presentation of Financial Statements, but not so narrow that it is inefficient to apply the interpretation process?	We believe this issue is sufficiently narrow in scope to be capable of interpretation within the confines of IFRSs and the *Framework for the Preparation and Presentation of Financial Statements*, but not so narrow that it is inefficient to apply the interpretation process.
If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project?	No current or planned IASB project will address this issue.

We believe that the clarification of the illustrative example would help with consistent application and reduce diversity in practice.

Appendix A

Draft additional implementation guidance

IG Example 12 A

Background

An entity grants 100 cash-settled share appreciation rights (SARs) to each of its 500 employees on condition that the employees remain in its employment for the next three years and the entity reaches a revenue target (CU1B in sales) at the end of Year 3.

For simplicity, it is assumed that no employees are expected to leave and none leave.

During year 1, the entity estimates there is a 40% probability that the revenue target will be attained at the end of Year 3. During Year 2, the entity estimates there is a 70% probability that the revenue target will be attained at the end of Year 3. At the end of Year 3, the revenue target was attained and 150 employees exercise their SARs, another 150 employees exercise their SARs at the end of year 4 and the remaining 200 employees exercise their SARs at the end of year 5.

Using an option pricing model the entity estimates the fair value of the SARs, ignoring the revenue target performance condition, at the end of each year in which a liability exists as shown below. At the end of Year 3, all SARs held by the remaining employees vest. The intrinsic values of the SARs at the date of exercise (which equal the cash paid out) at the end of years 3, 4 and 5 are also shown below.

Year	Fair value of one SAR	Intrinsic value of one SAR
1	CU14.40	
2	CU15.50	
3	CU18.20	CU15.00
4	CU21.40	CU20.00
5		CU25.00

Application of requirement

Year	Calculation		Expense CU	Liability CU
1	500 employees × 100 SARs × 40% × CU14.40 × ⅓		96,000	96,000
2	500 employees × 100 SARs × 70% × CU15.50 × ⅔ – CU96,000		265,667	361,667
3	(500-150) employees × 100 SARs × CU18.20 – CU361,667	275,333		637,000
	+ 150 employees × 100 SARs × CU15.00	225,000		
	Total		500,333	
4	(350 – 150) employees × 100 SARs × CU21.40 – CU637,000	(209,000)		428,000
	+ 150 employees × 100 SARs × CU20.00	300,000		
	Total		91,000	
5	CU0 – CU428,000	(428,000)		0
	+ 200 employees × 100 SARs × CU25.00	500,000		
	Total		72,000	
	Total		1.025,000	

Appendix B

Extracts from published guidance

PwC Manual of Accounting

12.150 There is, however, an important difference. For cash-settled transactions, the fair value of the liability is re-measured at each reporting date and at the date of settlement. The measurement reflects the impact of all conditions and all possible outcomes on a weighted-average basis, unlike the measurement for an equity-settled award. Any changes in fair value are recognised in profit or loss for the period. [IFRS 2 para 30].

KPMG Insights into IFRS

4.5.1260.40 Therefore, it is unclear whether, by analogy to the modified grant-date method for equity-settled share-based payments (see 4.5.780), only market conditions and non-vesting conditions should be taken into account when measuring the fair value of the cash-settled liability; or whether all conditions – including service and non-market performance conditions – should be taken into account in determining that fair value.

4.5.1260.50 In our view, an entity should choose an accounting policy, to be applied consistently to all cash-settled share-based payments, to measure the fair value of a cash-settled liability taking into account either:

- only market and non-vesting conditions, meaning that service and non-market performance conditions affect the measurement of the liability by adjusting the number of rights to receive cash based on the best estimate of the service and non-market performance conditions that are expected to be satisfied; or
- all vesting and non-vesting conditions, including service conditions and non-market performance conditions. [*IFRS 2.IG 19, Ex12*]

Deloitte iGAAP

Chapter A16, 5.3 Treatment of vesting conditions

Given the lack of clarity regarding how vesting conditions should be reflected in the fair value measurement, it appears that there are two acceptable approaches; an entity should measure the liability arising from a cash-settled share-based payment on one of the following bases:

- at true fair value (ie the fair value measurement of the liability reflects all vesting and non-vesting conditions, including service and non-market performance conditions); or
- by analogy to the measurement of equity-settled share-based payments (ie the fair value measurement of the liability reflects market and non-vesting conditions only. Service and non-market performance conditions are taken into account by adjusting the number of rights to receive cash that are expected to vest).

Ernst & Young International GAAP

Chapter 32, 9.3.2.C Non-market vesting conditions

As drafted, IFRS 2 does not specifically address the impact of vesting conditions in the context of cash-settled transactions - the provisions of IFRS 2 relating to vesting conditions are to be found in paragraphs 19-21 of IFRS 2, all of which fall under the main heading 'Equity-settled share-based payment transactions' immediately before paragraph 10.

Where a vesting condition is a minimum service period, IG Example 12 in IFRS 2 (broadly reproduced as Example 32.36 above) clearly indicates that, during the period to vesting, the liability should be estimated on the basis of the current best estimate of the number of awards that will vest, this estimate being made exactly as for an equity-settled transaction.

As regards other non-market performance conditions, based on the analogy of the treatment of service periods in IG Example 12, we believe that the liability until vesting date should be based on the current best estimate of the outcome of those conditions.